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Indemnification of Corporate Officers and Directors

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Abstract

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KEYWORDS: officers, directors, indemnification

Indemnification of Corporate Officers and Directors

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I. INTRODUCTION

Doing business through the legal fiction¹ of a corporate entity dates back to the Middle Ages.² The primary purpose for the creation of corporations is to insulate the principals from personal liability,³ which tends to encourage new enterprise. However, there are many circumstances under which officers and directors may be personally liable as a result of their acts or status in connection with the affairs of a

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1. The corporation is an "artificial being, invisible, intangible, and existing only in contemplation of law." *Trustees of Dartmouth College v. Woodward*, 17 U.S. (4 Wheat.) 518, 636 (1819). Apart from the persons through whom it acts, "a corporation is a mere incorporeal legal entity created by government." *Smetal Corp. v. West Lake Inv. Co.*, 126 Fla. 595, 626, 172 So. 58, 71 (1936).

2. Many towns and guilds sought protection for their business ventures by royal charter from the eleventh century onward. B. TIERNEY & S. PAINTER, *WESTERN EUROPE IN THE MIDDLE AGES* 240 (2d ed. 1970). Joint stock companies became prevalent as a means for funding and promoting overseas commerce in the sixteenth and seventeenth centuries. R. K. WEBB, *MODERN ENGLAND* 17 (1968). The right to form joint stock companies was severely limited in England after the disastrous collapse of speculative stocks in the "South Sea Bubble" of 1720. *Id.* at 24-25 (1968). The original purpose of joint stock companies was simply to spread the risk of an enterprise by increasing the number of investors, as the investors were individually liable for the company's obligations. Limited liability companies were not generally recognized until the mid-nineteenth century. *See id.* at 17; LANDES, *THE UNBOUND PROMETHEUS* 198 (1969).

3. *State ex rel. Continental Distilling Sales Co. v. Vocelle*, 158 Fla. 100, 102, 27 So. 2d 728, 729 (1946). It is not considered fraudulent or contrary to public policy to limit liability through use of the corporate form. *Miller v. Honda Motor Co.*, 779 F.2d 769, 773 (1st Cir. 1985).

corporation.⁴ Even if ultimately exonerated from personal liability, corporate officers and directors may be subjected to substantial expense and anxiety in defending claims asserted against them.

In recent years, the exposure of officers and directors has greatly expanded,⁵ as new theories of liability are developed by plaintiffs in search of a deep pocket. While a certain amount of personal accountability may be desirable,⁶ this trend may discourage qualified persons from serving as officers and directors.⁷

Corporations have attempted to mitigate the risk to their officers and directors by providing for their indemnification. The right to indemnification by an insolvent corporation may be of dubious value. Nevertheless, the law governing corporate indemnification is of critical concern where creditors are competing to recover against scarce corpo-

4. *E.g.*, *United States v. Wise*, 370 U.S. 405 (1962)(corporate officer criminally liable under Sherman Act, even though acts were committed in representative capacity on behalf of corporation); *New York v. Shore Realty Corp.*, 759 F.2d 1032 (2d. Cir. 1985)(corporate officer liable as "operator" for cleanup of toxic waste site under CERCLA, 42 U.S.C. § 9607); *Escude Cruz v. Ortho Pharmaceutical Corp.*, 619 F.2d 902, 907 (1st Cir. 1980)(corporate officer liable for active direction or participation in tortious conduct); *Higbie v. Kopy-Kat, Inc.*, 391 F. Supp. 808, 810 (E.D. Pa. 1975)("well established" that corporate officers and directors can be personally liable for antitrust damages for participating in or ratifying unlawful acts); *Shultz v. Chalk-Fitzgerald Constr. Co.*, 309 F. Supp. 1255 (D. Mass. 1970) (corporate officers can be liable as "employers" for unpaid overtime compensation under the Fair Labor Standards Act, 29 U.S.C. §§ 203(d), 216(b) (1988)); *see also* 12 U.S.C. §§ 1818(i), 1813(u)(1) (1988)("institution-affiliated party," which includes officers and directors, subject to civil penalties for misconduct in the affairs of a federally insured financial institution); 26 U.S.C. §§ 3401(3), 3401(d) (1988)("employer," defined as person having control over payment of wages, liable for unpaid withholding taxes). *But see* *Joslyn Corp. v. T.L. James Co.*, 696 F. Supp. 222 (W.D. La. 1988).

5. N. FEUER, *PERSONAL LIABILITIES OF CORPORATE OFFICERS AND DIRECTORS* 9 (1974).

6. Formation of a corporation is not a matter of right, but a privilege granted by the state. *Cook v. J.T. Case Plow Works Co.*, 88 Fla. 421, 426-27, 96 So. 292, 294 (1923)(Whitfield, J., concurring). It therefore follows that the privilege should not be abused by individuals seeking to avoid the consequences of their own wrongdoing.

7. *See, e.g.*, 1987 Fla. Laws ch. 245, § 1(2)("The Legislature further finds that the service of qualified persons on the governing boards of corporations. . . is in the public interest and that. . . such persons should be permitted to perform without undue concern for the possibility of litigation arising from the discharge of their duties as policy makers. . . .")(preamble to enactment of legislation precluding corporate directors from suffering personal liability for money judgments for litigation stemming from corporate acts, subject to exceptions); M. SHAEFTLER, *THE LIABILITIES OF OFFICE: INDEMNIFICATION AND INSURANCE OF CORPORATE OFFICERS AND DIRECTORS* 2 (1976).

rate assets, particularly where a victim of fraud or mismanagement may be subordinated to the individual who caused his loss.

In the wake of the troubles in the savings and loan and banking industry, and the failure of other businesses in the present economic downturn, there will be increasing pressure to identify responsible parties and hold them accountable. Conversely, corporate officers and directors will look to their indemnification rights, not only for actual reimbursement, but as a deterrent to potential plaintiffs.

This article will discuss the history of corporate indemnification, its present status, and offer comment on how the law may be improved to strike a better balance between the competing policies of promoting business interests and encouraging responsible corporate conduct.

II. HISTORICAL BACKGROUND

Prior to the enactment of statutory indemnification provisions, corporate indemnification was a matter of contract and the common law. If corporate articles and by-laws failed to provide for it, officers and directors were generally not entitled to indemnification.⁸ Like most states, Florida developed little law on the topic. Some jurisdictions evolved conflicting principles that failed to satisfy the corporate need for certainty.⁹

Within the context of shareholders' derivative suits,¹⁰ officers and directors who did not prevail could rarely obtain indemnification, and

8. W. KNEPPER & D. BAILEY, *LIABILITY OF CORPORATE OFFICERS AND DIRECTORS* § 20.01 (4th ed. 1988).

9. G. WASHINGTON & J. BISHOP, JR., *INDEMNIFYING THE CORPORATE EXECUTIVE* 79-82 (1963).

10. Shareholders' derivative suits are brought by plaintiffs purporting to act by or in the right of the corporation, and usually challenge some aspect of management's past or current actions. *BLACK'S LAW DICTIONARY* 1419 (6th ed. 1990) defines a "stockholder's derivative action," as

[a]n action by a stockholder for purpose of sustaining in his own name a right of action existing in the corporation itself, where corporation would be an appropriate plaintiff. It is based upon two distinct wrongs: the act whereby corporation was caused to suffer damage, and the act of corporation itself in refusing to redress such act.

These types of suits are entirely distinct from a shareholder's direct action, which is "a suit by a stockholder to enforce a right of action existing in him." *Wolfe v. American Sav. & Loan Assoc.*, 539 So. 2d 606, 607 (Fla. 3d Dist. Ct. App. 1989). Of course, third parties may also assert claims against the corporation, its officers, and directors. *See e.g.*, cases cited *supra* note 4.

could be held liable for misappropriation of corporate assets if they indemnified themselves over objection.¹¹ Distinctions eventually arose between officers and directors who acted in good faith in legitimate internal policy disputes, and those who were defeated in suits stemming from purely personal power contests.¹² The problem with this approach was that power struggles are usually couched in the language of policy disputes, and it became difficult to intelligently distinguish between "personal" and "policy" disputes.¹³

The law was little clearer in cases involving officers and directors who successfully defended derivative suits. Although some early decisions assumed it was appropriate to indemnify successful officers and directors,¹⁴ subsequent cases distinguished situations where they were successful, yet were sued on causes of action arising from personal dealings only indirectly involving their corporate responsibilities.¹⁵

Some states refined the standard by requiring successful officers and directors seeking indemnification to demonstrate some direct benefit to the corporation. However, the "direct benefit" requirement was also unsatisfactory. Entirely blameless officers and directors were sometimes forced to bear the expense of defending acts taken in their corporate capacities, due to failure to demonstrate that the litigation had directly benefitted the corporation. In the landmark case of *New York Dock Co. v. McCollum*,¹⁶ a corporation and its directors were denied indemnification despite their having successfully defended a derivative suit seeking appointment of a receiver. After incurring substantial expense, the directors sought a declaration from the court that they were entitled to indemnification. Although the court concluded that the corporation had benefitted by avoiding appointment of the receiver, it denied indemnification after finding that the successful defense was the result of corporate counsel's efforts, rather than those of the defendants. *McCollum* was widely criticized,¹⁷ and resulted in the 1941 enactment of the nation's first corporate indemnification statute.¹⁸

Direct benefit cases were based on the concept that, absent the

11. *E.g.*, *Wickersham v. Crittenden*, 106 Cal. 329, 39 P. 603 (1895); *Persey v. Millaudon*, 8 Mart. (N.S.) 68 (Orleans 1829).

12. G. WASHINGTON & J. BISHOP, JR., *supra* note 9, at 79-82.

13. *Id.* at 81.

14. *Id.* at 83.

15. *Id.* at 84.

16. 173 Misc. 106, 16 N.Y.S.2d 844 (N.Y. Sup. Ct. 1939).

17. *See* G. WASHINGTON & J. BISHOP JR., *supra* note 9, at 87-90.

18. W. KNEPPER & D. BAILEY, *supra* note 8, at § 20.04.

benefit, the corporation was without the power to indemnify.¹⁹ Some jurisdictions rejected the direct benefit requirement, and reasoned that successful officers and directors should be indemnified because they should have no lesser rights than would a trustee at common law.²⁰ These courts concluded that indirect benefits, such as demonstrating corporate management's honesty, were of value to the corporation.²¹ Still other courts allowed indemnification following successful defense upon the broader public policy grounds that without indemnification, it might be difficult to induce responsible persons to accept corporate office.²²

The law was also unclear in non-derivative actions such as suits brought by third parties or criminal prosecutions. Some courts permitted indemnification under an agency theory, and required a cause or link between the action taken as an agent and the subsequent litigation. In *Hoch v. Duluth Brewing and Malting Co.*,²³ a corporate director had briefly held title to a parcel of land as security for a debt to the corporation. Many years after the debt was paid, the federal government brought a civil fraud and conspiracy action against Hoch and various others in the chain of title charging that they had conspired to defraud the government of its land. Although the director defended successfully, the court refused to allow indemnification. The court reasoned that the director's loss was caused by entirely unpredictable government misconduct, for which the corporation was in no way responsible.²⁴ Other courts used the corporate benefit standard to find corporate power to voluntarily indemnify unsuccessful directors who had benefited the corporation in the process of being defeated.²⁵

19. Frampton, *Indemnification of Insiders' Litigation Expenses*, 23 LAW & CONTEMP. PROBS. 325, 327 (1958).

20. *Solimine v. Hollander*, 129 N.J. Eq. 264, 19 A.2d 344 (1941)(trustees at common law enjoyed right to indemnification, and corporate directors should enjoy the same right, based on their similar responsibilities). Officers and directors occupy a fiduciary or quasi fiduciary position, and though not technically trustees, occupy positions of trust and have analogous duties. *Etheredge v. Barrow*, 102 So. 2d 660 (Fla. 2d Dist. Ct. App. 1958).

21. *Solimine*, 129 N.J. Eq. at 273, 19 A.2d at 348.

22. *E.g., In re E.C. Warner Co.*, 232 Minn. 207, 45 N.W. 2d 388 (1950).

23. 173 Minn. 374, 217 N.W. 503 (1928).

24. *Id.* at 375, 217 N.W. at 504.

25. *See, e.g., Simon v. Socony-Vacuum Oil Co.*, 179 Misc. 202, 38 N.Y.S.2d 270 (N.Y. Sup. Ct. 1942), *aff'd mem.* 267 A.D. 890, 47 N.Y.S.2d 589 (N.Y. App. Div. 1944)(director's plea of *nolo contendere* facilitated settlement of separate criminal antitrust charges against the corporation).

Florida courts did not address these particular issues, however, Florida common law did require corporations to reimburse expenses necessarily incurred by corporate officers in the performance of their corporate duties, where the performance of those duties conferred a benefit on the corporation.²⁶ The obligation was based on an implied contract theory.²⁷

III. FLORIDA STATUTORY HISTORY

After the *McCollum* case, nearly all jurisdictions adopted statutes permitting officer and director indemnification in various circumstances.²⁸ Florida's first statutes on the subject were former sections 608.13 and 608.131, enacted in 1963.²⁹

Under section 608.13(14), corporations had the power to indemnify officers and directors in suits by or in the right of the corporation for reasonable fees and expenses "actually and necessarily incurred" in defense or settlement, except where the officers or directors were adjudged guilty of negligence or misconduct in the performance of their corporate duties.³⁰ Under subsection (15), applicable to third party actions including criminal proceedings, corporations were authorized to indemnify officers and directors for reasonable expenses "actually and necessarily incurred as a result" of the proceeding. This included amounts paid in settlement, to satisfy judgments, or in paying fines. The indemnification for defensive actions under subsection (15) was considerably broader than for suits as plaintiff under subsection (14), which did not provide for indemnification of amounts paid in settlement.³¹

However, persons seeking indemnification in third party actions were required to demonstrate a good faith reasonable belief that their actions were taken "in the best interests of the corporation."³² In criminal proceedings, the officer or director was also required to prove that he had no reasonable ground for belief that his actions were unlawful. The statute further provided that termination of civil or criminal ac-

26. *Flight Equip. and Eng'g Corp. v. Shelton*, 103 So. 2d 615, 625 (Fla. 1958).

27. *Id.*

28. N. FEUER, *supra* note 5, at 205.

29. 1963 Fla. Laws ch. 286; § 1, ch. 304, § 1.

30. FLA. STAT. § 608.13(14) (1963) (repealed 1975).

31. Compare FLA. STAT. § 608.13(14) with FLA. STAT. § 608.13(15) (1963) (repealed 1975).

32. § 608.13(15).

tions by settlement, conviction, judgment or plea of *nolo contendere* did not itself create a presumption that the above standards were violated.³³ The power to indemnify under section 608.13 existed unless otherwise provided by the corporation's certificate of incorporation.³⁴

Section 608.13(5) allowed successful plaintiffs in derivative actions to obtain the reasonable expenses of maintaining the suit, including attorneys' fees.³⁵ Under subsection (4), plaintiffs holding less than five percent of the corporation's outstanding shares could be required to post security for reasonable expenses, including attorneys' fees, for which the corporation might become liable for indemnification under section 608.13(14).³⁶ The security provisions were designed to prevent so-called "strike suits" by shareholders, and did not apply to plaintiffs owning stock valued in excess of \$50,000.00.³⁷

The 1963 indemnification statutes remained unchanged until 1970 and 1971, when they were substantially expanded. Under the 1971 statute, not only parties, but those threatened to be made parties, could be indemnified.³⁸ Additionally, the expenses to be indemnified did not have to be incurred in an action, but could also be incurred in a "threatened, pending or completed action, suit or proceeding."³⁹ Under subsection 14(a), applicable to non-derivative actions, the class of persons eligible for indemnification was expanded from officers and directors to include employees and agents.⁴⁰ Additionally, indemnification was made available to those affiliated with partnerships, joint ventures, trusts or other enterprises.⁴¹ These expansions also applied to derivative actions.⁴²

The 1971 statute also significantly changed the provisions applicable to derivative actions. Indemnification was only available upon meet-

33. *Id.*

34. FLA. STAT. § 608.13 (1963) (repealed 1975).

35. FLA. STAT. § 608.13(5) (1963) (repealed 1975).

36. FLA. STAT. § 608.13(4) (1963) (repealed 1975).

37. *See* Citizens Nat'l Bank v. Peters, 175 So. 2d 54 (Fla. 2d Dist. Ct. App. 1965); "Strike suits" are defined as derivative actions brought by shareholders with the ulterior purpose of inducing the defendants to buy the plaintiff's shares. *Leppert v. Lakebreeze Homeowners Assoc., Inc.*, 500 So. 2d 250, 252 (Fla. 1st Dist. Ct. App. 1987).

38. FLA. STAT. § 608.13(14) (1971).

39. *Id.*

40. § 608.13(14)(a).

41. *Id.*

42. § 608.13(14)(b).

ing the good faith and reasonable belief standards already applicable to third party actions.⁴³ However, the former statute's automatic exclusion from indemnification of those adjudged guilty of negligence or misconduct was relaxed to allow indemnification, if the court approved in view of all the circumstances.⁴⁴

In addition to altering the requirements for permissive indemnification in derivative and third party actions, the 1971 statute also incorporated the first mandatory indemnification provision. Under subsection 14(c), indemnification of expenses "actually and necessarily incurred" was available to those found "successful on the merits or otherwise in defense of any action, suit or [other] proceeding . . . or in defense of any claim, issue or matter therein."⁴⁵

The statute also provided mechanisms for approval of permissive indemnification, and broadened its availability. Subsection 14(d) established a requirement that permissive indemnification be approved by a majority vote of a quorum of disinterested members of the board of directors, or by non-party shareholders.⁴⁶ Under subsection (15), corporations were also empowered to advance expenses prior to the conclusion of the suit. This also required a majority vote of a quorum of disinterested directors or a majority vote of disinterested shareholders, and required that the person to be indemnified, or someone on his behalf, undertake to repay the advancement if it was not ultimately determined that indemnification was appropriate.⁴⁷ Subsection (16) created a non-exclusivity provision expressly recognizing that statutory indemnification under subsections (14) and (15) did not preclude other indemnification rights created under "by-law, agreement, vote of shareholders or disinterested directors, or otherwise."⁴⁸ Additionally, indemnification under subsections (14) and (15) was available for actions taken in an official capacity, or taken in another capacity while holding office.⁴⁹ Moreover, such indemnification was required to continue after the official's position terminated, and to inure to the benefit of the indemnitee's heirs, executors, and administrators.⁵⁰

Finally, under subsection (17), Florida adopted its first provision

43. *Id.*; cf. FLA. STAT. § 608.13(15).

44. *Id.*

45. FLA. STAT. § 608.13(14)(c) (1971) (repealed 1975).

46. § 608.13(14)(d).

47. § 608.13(15).

48. § 608.13(16).

49. *Id.*

50. *Id.*

allowing corporations to purchase and maintain directors' and officers' insurance. Such insurance could cover any liability asserted based upon acts in an official corporate capacity, or upon official status, and was not limited by the constraints of subsection (14).⁵¹

These statutes remained unchanged until 1975, when they were automatically repealed.⁵² Following repeal, the Legislature enacted a substantially revised statutory scheme based on the 1969 Model Corporation Business Act.⁵³ These revisions were part of the first comprehensive overhaul of Florida's corporation act since 1953,⁵⁴ but the new statute did not enact the Model Act verbatim.⁵⁵ The principal purpose of the revisions was described as clarification.⁵⁶ However, review of the 1975 statute demonstrates that a number of substantive changes were implemented.

The new statute, section 607.014, relaxed the permissive indemnification requirement from good faith and a reasonable belief that the acts taken were in the best interest of the corporation, to good faith belief that the acts taken were "not opposed to" the best interests of the corporation.⁵⁷ The statute also permitted indemnification of expenses "actually and reasonably incurred,"⁵⁸ although the prior statute required that the expenses be "actually and necessarily incurred." Section 607.014(5), providing for advancement of expenses, was clarified to require a finding that the subsection (1) or subsection (2) "good faith" and "reasonable belief" standards had been met.⁵⁹ Under sub-

51. § 608.13(17). The statute was also designed to facilitate the speedy provision of a defense during litigation. See SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT, S.B. 1096, 10th Leg. (April 23, 1987) ("[s]ince the section permits insurance coverage in areas not clearly indemnifiable by the corporation, directors and others were able to arrange with an insurance carrier for the funding of legal fees associated with the defense of a claim without having a preliminary determination by . . . procedures defined in the statute").

52. 1975 Fla. Laws ch. 250, § 139.

53. SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT, S.B. 1096, 10th Leg. (April 23, 1987).

54. SENATE JUDICIARY-CIVIL COMMITTEE, STAFF ANALYSIS, S.B. 520, 4th Leg. (May 23, 1975).

55. *Id.*

56. Letter from C. McFerrin Smith, III, Executive Director to the Law Revision Council, to the Office of the Governor (June 9, 1975).

57. FLA. STAT. § 607.014(1)(2) (1975) (repealed 1989); STAFF ANALYSIS, H.B. 1395, 4th Leg. (1975).

58. § 607.014(1)(2).

59. FLA. STAT. § 607.014(5) (1975) (repealed 1989).

section (6), the non-exclusivity provision was also clarified and set new limits. Under the new non-exclusivity provision, applicable to permissive indemnification by the corporation but not to court-approved indemnification as otherwise provided, indemnification was not allowed for acts involving gross negligence or willful misconduct.⁶⁰ Additionally, under subsection (9), corporations were required to provide notice to shareholders of indemnifications not authorized by a court, by the shareholders themselves, or paid for by insurance.⁶¹

Section 608.131 was also renumbered to 607.147 and revised.⁶² In addition, the Legislature enlarged the potential class of derivative plaintiffs by including those who were stockholders at the time of suit, although not necessarily at the time a cause of action accrued.⁶³ The Legislature also enacted the first provision authorizing courts to order unsuccessful plaintiffs to pay the defendants' reasonable expenses, including attorneys' fees, where the action was brought "without reasonable cause."⁶⁴

The 1975 version remained virtually unchanged until 1980, when the Legislature created a new alternative to approval of indemnification by disinterested directors or shareholder vote. Section 607.014(4)(b) permitted approval of indemnification by written opinion of independent legal counsel, in the absence of a quorum of disinterested directors, or if directed by such a quorum.⁶⁵ Additionally, section 607.014(5) was amended to provide that only the board of directors could authorize advance indemnification.⁶⁶ A 1981 amendment made clear that the Legislature intended the subsection (6) non-exclusivity provisions to apply equally to officers, directors, employees and agents.⁶⁷

IV. THE CURRENT STATUTE

The statute was substantially revised in 1987, and again in 1989.

60. FLA. STAT. § 607.014(6) (1975 (repealed 1989)).

61. FLA. STAT. § 607.014(9) (1975) (repealed 1989).

62. 1975 Fla. Laws ch. 80-349, § 50.

63. FLA. STAT. § 607.147(1) (1975) (repealed 1989).

64. FLA. STAT. § 607.147(4) (1975) (repealed 1989). However, the possibility of an unsuccessful plaintiff having to pay fees was apparently contemplated under former section 608.131(4).

65. 1980 Fla. Laws ch. 349, § 1.

66. *Id.*

67. 1981 Fla. Laws ch. 155, § 2.

The 1989 revisions updated the entire Corporation Act to more closely follow the Revised Model Business Corporation Act adopted by the American Bar Association in 1984.⁶⁸ The statute was further reorganized in 1990, but the present indemnification provisions are substantially unchanged from the 1987 version.⁶⁹

In 1987, section 607.014(2), which applies to derivative suits, was amended to permit indemnification of amounts paid in settlement which did not exceed the board of directors' estimate of the expense necessary to litigate the proceeding to a conclusion.⁷⁰ Previously, only amounts paid in settlement of third party actions could be indemnified. The purpose of the amendment was to encourage settlement of derivative actions.⁷¹ Additionally, the previous restrictions on permissive indemnification of those found liable for negligence or misconduct were broadened to include all those found liable in a proceeding. The more liberal restriction, however, did not apply to court-ordered indemnification.⁷² The Legislature also provided that any court of competent jurisdiction, not only the one where the proceeding was brought, could order indemnification.⁷³

Subsection (4) was also expanded in 1987 to allow indemnification approval by a committee designated by the board of directors.⁷⁴ Interested directors could participate in selecting the committee.⁷⁵ Additionally, if independent legal counsel was utilized, the means of selecting that counsel was expanded to permit selection by a disinterested board committee.⁷⁶ Subsection (5) was amended to provide that independent legal counsel could determine whether permissive indemnification con-

68. SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT, S.B. 1460, 11th Leg. (March 9, 1990); SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT, S.B. 0851, 11th Leg. (May 9, 1989).

69. The text of the pertinent provisions of the current statute is set out in the Appendix, *infra*.

70. FLA. STAT. § 607.014(2) (1987) (repealed 1989).

71. SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT, S.B. 1096, 10th Leg. (April 23, 1987). The apparent rationale was that there was no prejudice to the corporation in paying monies which would otherwise be spent in litigation. However, projecting litigation expenses is such a subjective exercise that management could conceivably justify almost any settlement.

72. § 607.014(2).

73. *Id.*

74. FLA. STAT. § 607.014(4)(b) (1987) (repealed 1989).

75. *Id.*

76. FLA. STAT. § 607.014(4)(c)(1)(2) (1987) (repealed 1989); SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT, S.B. 1096, 10th Leg. (April 23, 1987).

duct standards were met, but could not authorize the indemnification.⁷⁷

Subsection (6) was amended to make advancement of expenses virtually automatic upon a promise to repay, and to put the burden on the corporation to determine whether the party receiving advancement was not ultimately entitled and should repay after the conclusion of the action.⁷⁸ For employees and agents, even a promise to repay was unnecessary for advancement.⁷⁹ Under subsection (7), the non-exclusivity provision was clarified to demonstrate that it applied to advancement.⁸⁰ However, it was limited because it provided that indemnification was not allowed where a person's acts were material to a cause of action and (1) violated the criminal law without reasonable cause to believe that the conduct was lawful, (2) resulted in an officer receiving an improper personal benefit, (3) involved an improper dividend distribution, or (4) in derivative actions, involved willful misconduct or conscious disregard for the best interests of the corporation.⁸¹ The effect of these amendments was to sharply curtail the statute's non-exclusivity provisions for permissive indemnification. However, in the case of corporate directors, this was offset by the 1987 enactment of new liability limitations precluding a director's personal liability for monetary damages unless serious misconduct was demonstrated.⁸²

The continuing indemnification provisions of subsection (8) were amended to clarify their application to advancement, as well as indemnification. They were also amended to allow corporations, at the time they initially authorized indemnification or advancement, to limit its extent for persons no longer officers, directors, employees or agents, or their heirs.⁸³ Subsection (9) was also amended. The new version provided that unless a corporation's articles of incorporation stated otherwise, persons seeking indemnification or advancement could apply directly to a court.⁸⁴ Subsections (10) and (11) defined terms under the statute, and expanded the term "agent" to include volunteers.⁸⁵ Additionally, the "not opposed to the best interests of the corporation" stan-

77. FLA. STAT. § 607.014(5) (1987) (repealed 1989).

78. FLA. STAT. § 607.014(6) (1987) (repealed 1989); SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT, S.B. 1096, 10th Leg. (April 23, 1987).

79. § 607.014(6).

80. FLA. STAT. § 607.014(7) (1987) (repealed (1989)).

81. *Id.*

82. See 1989 Fla. Laws ch. 154, § 85.

83. FLA. STAT. § 607.014(8) (1987) (repealed 1989).

84. FLA. STAT. § 607.014(9)(a)(b)(c) (1987) (repealed 1989).

85. FLA. STAT. § 607.014(11)(e) (1987) (repealed 1989).

dard was defined to include consideration of the best interests of the participants and beneficiaries of employee benefit plans.⁸⁶

The 1987 Legislature also supplemented the indemnification provisions with new sections 607.1645 and 607.165, limiting corporate directors' personal liability for money judgments stemming from acts or failures to act concerning corporate management or policy decisions.⁸⁷ Under the new sections, directors were exempted from personal liability to the corporation, or any other persons, for acts or omissions regarding corporate management or policy, unless the director breached or otherwise failed to perform his duties and (1) violated the criminal law without reasonable cause to believe his conduct was lawful, (2) was engaged in a transaction from which he derived an improper personal benefit, (3) made an improper distribution, (4) engaged in willful misconduct or consciously disregarded the best interests of the corporation in a shareholders' derivative proceeding, or (5) in a non-derivative proceeding, committed reckless, bad faith, or malicious acts exhibiting willful and wanton disregard of human rights, safety or property.⁸⁸ "Recklessness" was defined as a director's conscious disregard of a risk known, or so obvious that it should have been known, and from which harm was "highly probable" to follow.⁸⁹

Certain limitations precluded a finding of improper personal benefit where the benefit and underlying transaction were not prohibited by state or federal authorities.⁹⁰ In non-derivative actions, a finding of improper personal benefit is precluded where the benefit was disclosed, approved by the directors or shareholders, and is fair and reasonable.⁹¹ Although a judgment or "other final adjudication" against a director in a criminal proceeding estopped him from contesting that his acts were a violation of the criminal law,⁹² the director was still entitled to attempt to prove that he had reasonable cause to believe his conduct was lawful, or no reasonable cause to believe it was unlawful.⁹³

Although this provision might appear to sharply curtail the need for director indemnification, it applies only to judgments, and has no

86. FLA. STAT. § 607.014(11)(g) (1987) (repealed 1989).

87. 1987 Fla. Laws. ch. 245, § 5, 6; FLA. STAT. §§ 607.1645, 607.165 (1987) (repealed 1989).

88. § 607.1645(1).

89. § 607.1645(2).

90. § 607.165(1).

91. § 607.165(1)(a)(b)(c).

92. § 607.1645(1)(b).

93. *Id.*

effect on a director's potential liability for attorneys' fees and other expenses of defense, or monies paid in settlement. To date, no judicial decisions have interpreted the statute.

In 1989, no significant amendments were made to Section 607.014 pertaining to indemnification in general.⁹⁴ However, in 1990, the Legislature renumbered the statute as section 607.0850.⁹⁵ As part of its statutory reorganization, the Legislature separated subsection (13) indemnification notice requirements from the rest of the indemnification statute. The new notice provisions are found at newly created section 607.1621.⁹⁶ The Legislature also reenacted former section 607.147, pertaining to derivative actions, which had been automatically repealed in 1989,⁹⁷ as new section 607.07401.⁹⁸ Under the current version, a court may no longer require shareholders' derivative suit plaintiffs to post security for the reasonable costs and expenses of the action.⁹⁹ The new director liability limitation provisions were also combined, renumbered and transferred to section 607.0831.¹⁰⁰

Subsection (1) of section 607.0850 provides for indemnification in third party actions and continues to employ the "good faith" and "reasonable belief" standards for actions taken in, or not opposed to, the best interests of the corporation.¹⁰¹ In criminal proceedings, indemnification remains available if the person had no reasonable cause to believe his conduct was unlawful.¹⁰² Subsection (2), applicable to actions by or in the right of the corporation, also continues to utilize the "good faith" and "reasonable belief" standards. However, it precludes indemnification for persons adjudged liable unless the court concludes that indemnification is "fair and reasonable" under the circumstances.¹⁰³ No standards are articulated to assist the court in making its

94. See generally SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT, S.B. 0851, 11th Leg. (May 9, 1989).

95. FLA. STAT. § 607.0850 (1990); SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT, S.B. 1460, 11th Leg. (March 9, 1990).

96. FLA. STAT. § 607.1621 (1990).

97. 1989 Fla. Laws ch. 154, § 166.

98. 1990 Fla. Laws ch. 179, § 148.

99. Compare FLA. STAT. § 607.147 (1975) (repealed 1989) with FLA. STAT. § 607.07401 (1990).

100. 1989 Fla. Laws ch. 154, § 85.

101. FLA. STAT. § 607.0850(1) (1990).

102. *Id.*

103. § 607.0850(2).

determination.¹⁰⁴

Subsection (3) continues to provide mandatory indemnification for officers, directors, agents and employees who are "successful on the merits or otherwise" in defense of a proceeding.¹⁰⁵ Subsection (4) limits the corporation to permissively indemnify only those persons meeting subsection (1) and (2) standards, and prescribes who may make the determination.¹⁰⁶ Subsection (5) provides a method for determining whether claimed expenses are reasonable, and continues to limit independent legal counsel to determining whether indemnification should be allowed while requiring others to set the amounts.¹⁰⁷ Advance indemnification remains available under subsection (6),¹⁰⁸ and the subsection (7) non-exclusivity provisions remain intact although subject to exceptions.¹⁰⁹ Under subsection (8), indemnification and advancement remain.¹¹⁰ Under subsection (9), a court of competent jurisdiction remains empowered to order indemnification upon application and proof of certain standards.¹¹¹ Subsections (10) and (11) provide various definitions and subsection (12) allows a corporation to purchase directors' and officers' insurance.¹¹² Section 607.1621 continues to require notice to shareholders for indemnification other than by court order, insurance, or the shareholders themselves.¹¹³ The notice must be sent prior to the next shareholders' meeting, and requires specification of the persons paid, amounts paid, and the nature of the litigation involved.¹¹⁴

Under section 617.028, section 607.0850 indemnification is also available to the directors, managers and trustees of non-profit corporations and rural electric cooperatives.¹¹⁵ The section 607.0831 director liability limitation provisions remain unchanged from the 1989 version, but former section 607.147(4) provisions providing for payment of expenses including attorneys' fees in shareholders' derivative actions brought without reasonable cause, was rewritten when it was trans-

104. *Id.*

105. § 607.0850(3).

106. § 607.0850(4).

107. § 607.0850(5).

108. § 607.0850(6).

109. § 607.0850(7).

110. § 607.0850(8).

111. § 607.0850(9)(a)(b)(c).

112. § 607.0850(10)(11)(12).

113. FLA. STAT. § 607.1621(1) (1990).

114. *Id.*

115. FLA. STAT. § 617.028 (1990).

ferred to section 607.07401(5).

V. ANALYSIS AND COMMENT

A. *Derivative Actions*

Although not strictly speaking an indemnification statute, the provisions of current statute section 607.07401(5)(a) effectively supplement Florida's statutory indemnification scheme and provide as follows: "On termination of the proceeding, the court may require the plaintiff to pay any defendant's reasonable expenses, including reasonable attorneys' fees, incurred in defending the proceeding if it finds that the proceeding was commenced without reasonable cause."¹¹⁶

Several points concerning section 607.07401(5) merit comment. First, the claim for fees arises upon "termination of the proceeding." Former statute section 607.147(4) applied only "upon final judgment,"¹¹⁷ apparently barring any claim on a case settled short of judgment.

Second, the court must find that the proceeding was brought without reasonable cause, which has been interpreted to require that there be no merit to any of the claims advanced against any of the parties. In *Winner v. Cataldo*,¹¹⁸ the Third District Court of Appeal observed that to allow a single successful defendant fees against the plaintiff would have a chilling effect on meritorious derivative claims. Perhaps the court was concerned that minority shareholders would ordinarily not be in a position to determine which of the officers or directors were at fault, and believed it was appropriate to permit the plaintiff to sue them all and require the defendants to establish among themselves who was responsible.¹¹⁹

However, as the award of fees is purely discretionary, the deterrent effect against meritless claims is questionable. The defendant could establish a stronger claim to fees merely by offering a nominal settlement under Rule 1.442, Florida Rules of Civil Procedure.¹²⁰

116. FLA. STAT. § 607.07401(5) (1990).

117. Compare FLA. STAT. § 607.147(4) (1975) (repealed 1989) with FLA. STAT. § 607.07401(5) (1990).

118. 559 So. 2d 696 (Fla. 3d Dist. Ct. App. 1990).

119. See, e.g., *Bowman v. Redding & Co.*, 449 F.2d 956, 967-68 (D.C. Cir. 1971); *Vahey v. Sacin*, 126 Cal. App. 3d 171, 178 Cal. Rptr. 559 (Cal. Dist. Ct. App. 1981) (burden on defendant to show which of multiple tortfeasors caused the harm).

120. The court may impose sanctions equal to reasonable attorneys' fees and all

The absence of reasonable cause is a difficult standard in view of the modest requirements for bringing a derivative suit. Cases interpreting earlier versions of the statute held that plaintiff stockholders were not required to have direct knowledge of misconduct in order to bring a derivative action.¹²¹ If the record reflected colorable support for the claims asserted, the action was considered viable.¹²² The current statute requires a verified complaint alleging with particularity the action taken to obtain remedial board action, but does not otherwise appear to require direct knowledge.¹²³ Additionally, the plaintiff need not be a stockholder at the time the action is brought; it is sufficient if he was a stockholder at the time the cause of action arose.¹²⁴

Finally, as "reasonable cause" is understood to be something less than "probable cause,"¹²⁵ and initiating an action without probable cause is actionable as malicious prosecution,¹²⁶ there appears to be little if any benefit to asserting a claim for fees under section 607.07401(5). A successful defendant who could establish the absence of probable cause in a separate action would be absolutely entitled to recover. The same defendant claiming fees at the conclusion of a successful defense against a derivative action could recover only if he could satisfy the more stringent absence of reasonable cause standard, and recovery would still be subject to the virtually unbridled discretion of the trial court.

Balanced against the defendant's potential indemnification or recovery of fees is the successful plaintiff's claim for fees. Section 607.07401(6) permits the court to award the successful plaintiff in a derivative action his reasonable expenses, including attorneys' fees.¹²⁷ The court must first find, however, some benefit to the corporation or

reasonable costs of the litigation from the date of an offer of judgment which was unreasonably rejected, where the damages awarded to the offeree are less than 75 percent of the offer. FLA. R. CIV. P. 1.442(h), *superseding in part* FLA. STAT. §§ 768.79, 45.061 (1990). See The Florida Bar Re: Amendment to Rules, 550 So. 2d 442 (Fla. 1989).

121. DiGiovanni v. All-Pro Golf, Inc., 332 So. 2d 91 (Fla. 2d Dist. Ct. App. 1976).

122. *Id.* at 94.

123. FLA. STAT. § 607.07401(2) (1990).

124. § 607.07401(1).

125. United States v. Hernandez-Salazar, 813 F.2d 1126, 1133 (11th Cir. 1987).

126. See Burns v. GCC Beverages, 502 So. 2d 1217, 1218 (Fla. 1986).

127. FLA. STAT. § 607.07401(6) (1990). See *infra* Appendix.

the other shareholders.¹²⁸

The defendants cannot thwart recovery by voluntarily granting the plaintiff's requested relief before judgment. Where the case is rendered moot by corporate action, the corporation has the burden of establishing the action was not caused by the lawsuit.¹²⁹ However, although section 607.07401(4) requires court approval for settlement of derivative claims, and subsections (5) and (6) permit the court to award fees, the court is without authority to require payment of fees as part of a settlement.¹³⁰

B. *Other Indemnification*

Little case law interprets the permissive indemnification provisions of section 607.0850 and its predecessor statutory versions. As earlier outlined, sections 607.0850(1),(2) and (9), Florida Statutes, permit a corporation to indemnify its officers and directors, and subsection (6) permits advancement of expenses of defense prior to determination of the controversy.¹³¹ These provisions are subject only to the conflict of interest limitations of section 607.0850(4), which generally require the interested officer or director to abstain from the corporation's determination of indemnification.

Although it has been argued that the language of subsection (4) implies that the court may order indemnification under sections (1) or (2) if the corporation refuses, the Third District Court of Appeal ruled in *Mosley v. DeMoya*¹³² that these provisions merely permit the corporation to indemnify if it sees fit.

The only mandatory indemnification provision is found in 607.0850(3).¹³³ Subsection (3) mandatory indemnification is self-executing, and does not depend on a corporation's enactment of an ena-

128. *Id.*; see also *Lane v. Head*, 566 So. 2d 508 (Fla. 1990); *United Parts, Inc. v. Tillis*, 432 So. 2d 674 (Fla. 5th Dist. Ct. App. 1983)(both interpreting former section 607.147(5), Florida Statutes).

129. *Ginsberg v. Keehn*, 550 So. 2d 1145 (Fla. 3d Dist. Ct. App. 1989)(interpreting former section 607.147(5), Florida Statutes).

130. *Levenson v. American Laser Corp.*, 438 So. 2d 179 (Fla. 2d Dist. Ct. App. 1983)(interpreting former section 607.147(2)(5), Florida Statutes).

131. FLA. STAT. § 607.0850(1),(2) and (9) (1990). See *infra* Appendix.

132. 497 So. 2d 696 (Fla. 3d Dist. Ct. App. 1986)(interpreting former section 607.014(1)(2)(4), Florida Statutes).

133. See *infra* Appendix.

bling provision in its articles of incorporation or elsewhere.¹³⁴ The only apparent limitation on this entitlement to indemnification is that the conduct giving rise to the claim must not have been *ultra vires*.¹³⁵ Although Florida's jurisprudence has not addressed any particularly egregious examples of claims arising from corporate status but based upon *ultra vires* acts of corporate officials, the problem has occasionally arisen in other states with similar statutes.¹³⁶

The "successful on the merits or otherwise" language is one of the statute's more controversial provisions and has not been uniformly adopted by all Model Act jurisdictions. Under the Model Act and statutes following it, a defense must be "wholly successful on the merits or otherwise."¹³⁷ Other jurisdictions have adopted the more rigorous standard of "successful on the merits."¹³⁸ It is difficult to understand why adding "or otherwise" was deemed necessary. A defendant who prevails for any reason is absolutely entitled to indemnification, which is the identical result achieved if the statute simply required indemnification for any successful defendant. Equally mysterious is why the Legislature determined that a corporate defendant who escaped liability on a mere technicality should be entitled to indemnification at all. Although the proponents of the Model Business Corporation Act explained that it would be "unreasonable to require a defendant with a valid procedural defense to undergo a possibly prolonged and expensive trial on the merits in order to establish eligibility for mandatory indem-

134. *Penthouse North Ass'n, Inc. v. Lombardi*, 436 So. 2d 184 (Fla. 4th Dist. Ct. App. 1983)(interpreting former section 607.014(3), Florida Statutes).

135. *See, State ex rel. Blatt v. Panelfab Int'l Corp.*, 314 So. 2d. 196 (Fla. 3d Dist. Ct. App. 1975)(mandamus compelling indemnification under former section 607.014(3), Florida Statutes, inappropriate for successful defense of criminal charges where record disclosed a fact dispute as to whether the underlying conduct resulted in whole or in part from conduct outside scope of corporate duties).

136. *E.g., Kaufman v. CBS, Inc.*, 135 Misc. 2d 64, 514 N.Y.S.2d 621 (N.Y. City Civ. Ct. 1987). Kaufman, a former CBS vice president, was sued by a female employee for a variety of intentional torts after he allegedly "grabbed" a piece of her clothing and made a lewd remark about her at a business dinner. Interpreting New York's analogous statute, the court found that the conduct was an "obvious deviation" from Kaufman's work responsibilities and could not reasonably be construed as an act within the scope of employment. *Id.*, 514 N.Y.S.2d at 621.

137. Model Business Corp. Act Ann. § 1120.1 (3d ed. 1984).

138. *See American Nat'l Bank & Trust Co. v. Schigur*, 148 Cal. Rptr. 116, 83 Cal. App. 3d 799 (Cal. Ct. App. 1978)(construing CAL. CORP. CODE § 317(d) (West 1977)).

nification,"¹³⁹ this does not explain why the expenses of the litigation should be shifted from the wrongdoer to the corporation. Officers and directors who happen to be sued and win should be required to make a case to the corporation for permissive indemnification, or at very least be subject to the "good faith" and "reasonable belief" requirements of section 607.0850(1) and (2).

Moreover, Florida's omission of the Model Act's "wholly successful" standard may make it necessary to indemnify those who are partially successful in defending an action but may be unsuccessful as a whole. Jurisdictions lacking this language have faced difficult problems in separating expenses subject to indemnification from those which are not. In *Merritt-Chapman & Scott Corp. v. Wolfson*,¹⁴⁰ a Delaware court was forced to determine whether a criminal defendant who had successfully obtained dismissal of a federal securities fraud element of a conspiracy count, but was later convicted on the count, was entitled to mandatory indemnification. Although the court concluded that Delaware's indemnification statute¹⁴¹ did not allow indemnification for this type of partial success, another appellate panel subsequently had to resolve whether Wolfson was entitled to mandatory indemnification for dismissal of some counts despite conviction on others. Reasoning that statutory language did not require success in all aspects of the suit, and that in a criminal action, any result other than a conviction was a success, the court concluded that Wolfson was entitled to indemnification for counts dismissed under a plea bargain agreement.¹⁴²

What constitutes "success on the merits or otherwise" has been heavily litigated. Voluntary dismissals with prejudice,¹⁴³ dismissals for failure to post security for expenses (even where the suit was subsequently refiled),¹⁴⁴ failure to indict following an investigation,¹⁴⁵ dismissal of some although not all charges,¹⁴⁶ outright acquittal,¹⁴⁷ a plaintiff

139. W. KNEPPER & D. BAILEY, *supra* note 8, at § 20.11.

140. 264 A.2d 358 (Del. Super. Ct. 1970)[hereinafter "*Wolfson I*"].

141. Del. Code Ann. tit. 8, § 145(c) (1969).

142. *Merritt-Chapman & Scott Corp. v. Wolfson*, 321 A. 2d 138 (Del. Super. Ct. 1974)[hereinafter "*Wolfson II*"].

143. *B&B Inv. Club v. Kleinert's, Inc.*, 472 F. Supp. 787 (E.D. Pa. 1979).

144. *Tichner v. Andrews*, 193 Misc. 1050, 85 N.Y.S.2d 760 (N.Y. Sup. Ct. 1949).

145. *Stewart v. Continental Copper & Steel Indus., Inc.*, 67 A.D. 293, 414 N.Y.S.2d 910 (N.Y. App. Div. 1979).

146. *Wolfson I*, 264 A.2d 358.

147. *Green v. Westcap Corp.*, 492 A.2d 260 (Del. Super. Ct. 1985); *PS&S, Inc.*

voluntarily requesting a non-suit,¹⁴⁸ and dismissal with prejudice due to bar by the statute of limitations,¹⁴⁹ have all been found encompassed within the phrase "or otherwise."

Some courts have found it necessary to draw a line and refuse indemnification for technical successes without substantive meaning. In *Galdi v. Berg*,¹⁵⁰ a federal district court construing Delaware's indemnification statute refused to permit indemnification for a defendant after the plaintiff voluntarily dismissed its case without prejudice. The court noted that another suit was currently being litigated which involved exactly the same issues, and concluded that despite the dismissal, the issue remained unresolved because it survived in the other suit. Accordingly, the court determined that the defendant had failed to obtain success on the merits or otherwise. In another instance, a court technically required to acquit a defendant of criminal charges, expressed its belief that the defendant should or would still be punished in civil actions.¹⁵¹ Nevertheless, that same defendant subsequently obtained indemnification for his successful defense of the criminal charges after the court concluded that Delaware's subsection 145(a) and 145(b) requirements for good faith, were not incorporated by reference into section 145(c) "successful on the merits or otherwise" standard.¹⁵²

In the context of the current troubles with failed financial institutions, the Office of Thrift Supervision has promulgated regulations allowing administrative authorities to object to indemnification of some former savings and loan officers and directors under applicable statutes. Under the federal regulations, the objection will automatically prohibit indemnification.¹⁵³

Eliminating the "or otherwise" language would limit required indemnification to situations where a judicial determination has been made on the merits. For example, in *American National Bank and*

v. Superior Court, 17 Cal. App. 3d 354, 94 Cal. Rptr. 738 (Cal. Ct. App. 2d Dist. 1971).

148. *Stanley v. Brassfield*, Cowan & Howard, 152 Ill. App. 378, 504 N.E.2d 542 (Ill. App. Ct. 1987).

149. *Dornan v. Humphrey*, 278 A.D. 1010, 106 N.Y.S.2d 142 (N.Y. App. Div. 1951).

150. 359 F. Supp. 698 (D. Del. 1973).

151. *Green*, 492 A.2d 260.

152. *Id.* These provisions are analogous to section 607.0850(1)(2)(3), Florida Statutes. See *infra* Appendix.

153. 12 C.F.R. § 545.121(c)(2)(iii)(1990).

Trust Co. v. Schigur,¹⁵⁴ a California court refused to allow mandatory indemnification following a settlement and voluntary dismissal with prejudice. Contrasting the California provision requiring "success on the merits"¹⁵⁵ with the Model Act provision requiring "success on the merits or otherwise," the court held that because the merits were not judicially determined, no indemnification was required.¹⁵⁶

Since permissive indemnification is still available under subsections (1) and (2) of Florida Statutes section 607.0850, elimination of the "or otherwise" language would still allow indemnification in most situations where procedural defenses prevailed, should the corporation decide it was appropriate. If, as suggested by some courts, the purpose of the mandatory indemnification provision is to prevent vindicated officers and directors from a corporation's refusal to indemnify after change in management, this problem could be treated by drafting a mandatory indemnification provision broad enough to encompass adverse managerial shifts while not requiring mandatory indemnification of those who escape liability other than on the merits.¹⁵⁷

Further statutory clarification of mandatory indemnification may also be necessary in other contexts. At least one court has concluded that the word "successful" requires appellate finality, thereby precluding mandatory indemnification where a judgment has been rendered in an officer's or director's favor but an appeal still remains pending.¹⁵⁸ Other courts have wrestled with the necessity of indemnifying former attorneys for corporations who successfully defend malpractice suits brought against them by their prior clients. In this context, a California court concluded in *Katayama v. Interpacific Properties, Inc.*,¹⁵⁹ that former corporate counsel was clearly "an agent" of the corporation and was encompassed within the meaning of section 317(d) of California's Corporation Act¹⁶⁰ during the time he represented the corporation and committed the acts for which he was later sued. The court found the statute "straightforward and unambiguous" and held that its "literal terms" required considering attorneys as agents for the corporation

154. 83 Cal. App. 3d 790, 148 Cal. Rptr. 116 (Cal. Ct. App. 1978).

155. Cal. Corp. Code § 317(d) (West 1988).

156. *Schigur*, 83 Cal. App. 3d 790, 148 Cal. Rptr. 116.

157. See *Western Fiberglass, Inc. v. Kirton, McConkie & Bushnell*, 789 P.2d 34 (Utah Ct. App. 1990).

158. *Luessier v. Mau-Van Dev., Inc.*, 4 Haw. App. 421, 667 P.2d 830 (Haw. Ct. App. 1983).

159. 190 Cal. App. 3d 1604, 236 Cal. Rptr. 108 (Cal. Ct. App. 1987).

160. This section is analogous to section 607.0850(3), Florida Statutes.

who would therefore be eligible for indemnification upon successfully defending a legal malpractice action.¹⁶¹

However, at least one other court reached precisely the opposite conclusion. In *Western Fiberglass, Inc. v. Kirton, McCorkie & Bushnell*,¹⁶² a Utah court decided that "agent" as defined by section 16-10-4(2)(c), Utah Statutes,¹⁶³ did not include law firms engaged by corporations to give legal advice. The would-be "agent" seeking indemnification in *Western Fiberglass* was an attorney sued for malpractice after rendering advice to a corporation. While the jury found for the attorney on one count, it found the attorney and the corporation equally negligent on another. The *Western Fiberglass* court used a combination of policy and statutory analysis to reach its determination, and dismissed the *Katayama* analysis as "one unpublished decision" without any further discussion.¹⁶⁴ The court concluded that the statutory definition of "agent" referred to persons with management discretion and the ability to bind the corporation.¹⁶⁵

If the statute were truly intended to be limited to managing or controlling persons, why was the broad language of "agent or employee" chosen? This reasoning would also preclude mandatory indemnification of attorneys who were sued by third parties along with the corporation and its management, for acts done at the corporation's discretion. Eliminating attorney entitlement to mandatory indemnification in all instances could have serious ramifications. Corporations could be deprived of the full assistance of counsel based upon the chilling effect of claims either not necessarily covered by malpractice insurance, or excessive premiums based from loss experience. The court in *Western Fiberglass* was obviously reaching for a means to avoid the unconscionable indemnification of an attorney found negligent.

Moreover, although the Legislature may never have intended section 607.0850(3) to apply to derivative actions, there is nothing in the statute to dictate otherwise. To the contrary, the Third District Court of Appeal indicated in dictum contained in *Winner*¹⁶⁶ that former 607.014(3), now 607.0850(3), would apply to derivative actions.

161. *Id.* The court also saw no policy reasons why this construction should not be allowed, as corporations were often subjected to rules not imposed on real persons, and were likely to be able to pursue expensive litigation more easily than an individual.

162. 789 P. 2d 34 (Utah Ct. App. 1990).

163. This section is analogous to section 607.0850, Florida Statutes.

164. 789 P.2d at 36.

165. *Id.* at 38.

166. *Winner v. Cataldo*, 559 So. 2d 696 (Fla. 3d Dist. Ct. App. 1990).

Section 607.07401(5),¹⁶⁷ which assumably was supposed to strike a careful balance between the rights of majority and minority stockholders, is undermined. The policy of encouraging meritorious derivative claims is frustrated by the availability of mandatory indemnification under 607.0850(3), which is apparently available to any successful corporate official defendant, regardless of the culpability of his codefendants, or even his own wrongdoing, so long as he prevails. Even plaintiffs with meritorious claims may be reluctant to sue if they face a "stonewall" defense, and the prospect of paying not only their own fees, but funding management's defense indirectly through their investment in the corporation.

Section 607.0850(3) should either be expressly excepted from application to derivative actions, or the Legislature should arrive at a consistent approach to indemnification. We suggest at the very least requiring success on the merits.

Corporate officials who are innocent or merely negligent are entitled to protection. Otherwise, there is little purpose in establishing a corporation at all. Furthermore, excessive risks to officers and directors will tend to discourage any responsible individual from serving. What possible justification can there be, however, for rewarding the intentional wrongdoer?

APPENDIX

Section 607.0850 is entitled: "Indemnification of officers, directors, employees, and agents" and provides:

(1) A corporation shall have power to indemnify any person who was or is a party to any proceeding (other than an action by, or in the right of, the corporation), by reason of the fact that he is or was a director, officer, employee, or agent of the corporation or is or was serving at the request of the corporation as a director, officer, employee, or agent of another corporation, partnership, joint venture, trust, or other enterprise against liability incurred in connection with such proceeding, including any appeal thereof, if he acted in good faith and in a manner he reasonably believed to be in, or not opposed to, the best interests of the corporation and, with respect to any criminal action or proceeding, had no reasonable cause to believe his conduct was unlawful. The termination of any proceeding by judgment, order, settlement, or conviction or upon a plea of *nolo contendere* or its equivalent shall not, of

167. See *supra* notes 123-30 and accompanying text.

itself, create a presumption that the person did not act in good faith and in a manner which he reasonably believed to be in, or not opposed to, the best interests of the corporation or, with respect to any criminal action or proceeding, had reasonable cause to believe that his conduct was unlawful.

(2) A corporation shall have power to indemnify any person, who was or is a party to any proceeding by or in the right of the corporation to procure a judgment in its favor by reason of the fact that he is or was a director, officer, employee, or agent of the corporation or is or was serving at the request of the corporation as a director, officer, employee, or agent of another corporation, partnership, joint venture, trust, or other enterprise, against expenses and amounts paid in settlement not exceeding, in the judgment of the board of directors, the estimated expense of litigating the proceeding to conclusion, actually and reasonably incurred in connection with the defense or settlement of such proceeding, including any appeal thereof. Such indemnification shall be authorized if such person acted in good faith and in a manner he reasonably believed to be in, or not opposed to, the best interests of the corporation, except that no indemnification shall be made under this subsection in respect of any claim, issue, or matter as to which such person shall have been adjudged to be liable unless, and only to the extent that, the court in which such proceeding was brought, or any other court of competent jurisdiction, shall determine upon application that, despite the adjudication of liability but in view of all circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses which such court shall deem proper.

(3) To the extent that a director, officer, employee, or agent of a corporation has been successful on the merits or otherwise in defense of any proceeding referred to in subsection (1) or subsection (2), or in defense of any claim, issue, or matter therein, he shall be indemnified against expenses actually and reasonably incurred by him in connection therewith.

(4) Any indemnification under subsection (1) or subsection (2), unless pursuant to a determination by a court, shall be made by the corporation only as authorized in the specific case upon a determination that indemnification of the director, officer, employee, or agent is proper in the circumstances because he has met the applicable standard of conduct set forth in subsection (1) or subsection (2). Such determination shall be made:

(a) By the board of directors by a majority vote of a quorum consisting of directors who were not parties to such proceeding;

(b) If such a quorum is not obtainable or, even if obtainable, by majority vote of a committee duly designated by the board of directors (in which directors who are parties may participate) consisting solely of two or more directors not at the time parties to the proceeding;

(c) By independent legal counsel:

(1) Selected by the board of directors prescribed in paragraph (a) or the committee prescribed in paragraph (b); or

(2) If a quorum of the directors cannot be obtained for paragraph (a) and the committee cannot be designated under paragraph (b), selected by majority vote of the full board of directors (in which directors who are parties may participate); or

(d) By the shareholders by a majority vote of a quorum consisting of shareholders who were not parties to such proceeding or, if no such quorum is obtainable, by a majority vote of shareholders who were not parties to such proceeding.

(5) Evaluation of the reasonableness of expenses and authorization of indemnification shall be made in the same manner as the determination that indemnification is permissible. However, if the determination of permissibility is made by independent legal counsel, persons specified by paragraph (4)(c) shall evaluate the reasonableness of expenses and may authorize indemnification.

(6) Expenses incurred by an officer or director in defending a civil or criminal proceeding may be paid by the corporation in advance of the final disposition of such proceeding upon receipt of an undertaking by or on behalf of such director or officer to repay such amount if he is ultimately found not to be entitled to indemnification by the corporation pursuant to this section. Expenses incurred by other employees and agents may be paid in advance upon such terms or conditions that the board of directors deems appropriate.

(7) The indemnification and advancement of expenses provided pursuant to this section are not exclusive, and a corporation may make any other or further indemnification or advancement of expenses of any of its directors, officers, employees, or agents, under any bylaw, agreement, vote of shareholders or disinterested directors, or otherwise, both as to action in his official capacity and as to action in another capacity while holding such office. However, indemnification or advancement of expenses shall not be made to or on behalf of any director, officer, employee, or agent if a judgment or other final adjudication establishes that his actions, or omissions to act, were material to the cause of action so adjudicated and constitute:

(a) A violation of the criminal law, unless the director, officer, em-

ployee, or agent had reasonable cause to believe his conduct was lawful or had no reasonable cause to believe his conduct was unlawful;

(b) A transaction from which the director, officer, employee, or agent derived an improper personal benefit;

(c) In the case of a director, a circumstance under which the liability provisions of s. 607.0834 are applicable; or

(d) Wilful misconduct or a conscious disregard for the best interests of the corporation in a proceeding by or in the right of the corporation to procure a judgment in its favor of in a proceeding by or in the right of a shareholder.

(8) Indemnification and advancement of expenses as provided in this section shall continue as, unless otherwise provided when authorized or ratified, to a person who has ceased to be a director, officer, employee, or agent and shall inure to the benefit of the heirs, executors, and administrators of such a person, unless otherwise provided when authorized or ratified.

(9) Unless the corporation's articles of incorporation provide otherwise, notwithstanding the failure of a corporation to provide indemnification, and despite any contrary determination of the board or of the shareholders in the specific case, a director, officer, employee, or agent of the corporation who is or was a party to a proceeding may apply for indemnification or advancement of expenses, or both, to the court conducting the proceeding, to the circuit court, or to another court of competent jurisdiction. On receipt of an application, the court, after giving any notice that it considers necessary, may order indemnification and advancement of expenses, including expenses incurred in seeking court-ordered indemnification or advancement of expenses, if it determines that:

(a) The director, officer, employee, or agent is entitled to mandatory indemnification under subsection (3), in which case the court shall also order the corporation to pay the director reasonable expenses incurred in obtaining court-ordered indemnification or advancement of expenses;

(b) The director, officer, employee, or agent is entitled to indemnification or advancement of expenses, or both, by virtue of the exercise by the corporation of its power pursuant to subsection (7); or

(c) The director, officer, employee, or agent is fairly and reasonably entitled to indemnification or advancement of expenses, or both, in view of all the relevant circumstances, regardless of whether such person met the standard of conduct set forth in subsection (1), subsection (2), or subsection (7).

(10) For purposes of this section, the term "corporation" includes, in addition to the resulting corporation, any constituent corporation (including any constituent of a constituent) absorbed in a consolidation or merger, so that any person who is or was a director, officer, employee, or agent of a constituent corporation, or is or was serving at the request of a constituent corporation as a director, officer, employee, or agent of another corporation, partnership, joint venture, trust, or other enterprise, is in the same position under this section with respect to the resulting or surviving corporation as he would have with respect to such constituent corporation if its separate existence had continued.

(11) For purposes of this section:

(a) The term "other enterprises" includes employee benefit plans;

(b) The term "expenses" includes counsel fees, including those for appeal;

(c) The term "liability" includes obligations to pay a judgment, settlement, penalty, fine (including an excise tax assessed with respect to any employee benefit plan), and expenses actually and reasonably incurred with respect to a proceeding;

(d) The term "proceeding" includes any threatened, pending, or completed action, suit, or other type of proceeding, whether civil, criminal, administrative, or investigative and whether formal or informal;

(e) The term "agent" includes a volunteer;

(f) The term "serving at the request of the corporation" includes any service as a director, officer, employee, or agent of the corporation that imposes duties on such persons, including duties relating to an employee benefit plan and its participants or beneficiaries; and

(g) The term "not opposed to the best interest of the corporation" describes the actions of a person who acts in good faith and in a manner he reasonably believes to be in the best interests of the participants and beneficiaries of an employee benefit plan.

(12) A corporation shall have power to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee, or agent of the corporation or is or was serving at the request of the corporation as a director, officer, employee, or agent of another corporation, partnership, joint venture, trust, or other enterprise against any liability asserted against him and incurred by him in any such capacity or arising out of his status as such, whether or not the corporation would have the power to indemnify him against such liability under the provisions of this section.

Companion section 607.0831, entitled "Liability of directors," provides:

(1) A director is not personally liable for monetary damages to the corporation or any other person for any statement, vote, decision, or failure to act, regarding corporate management or policy, by a director, unless:

(a) The director breached or failed to perform his duties as a director; and

(b) The director's breach of, or failure to perform, those duties constitutes:

1. A violation of the criminal law, unless the director had reasonable cause to believe his conduct was lawful or had no reasonable cause to believe his conduct was unlawful. A judgment or other final adjudication against a director in any criminal proceeding for a violation of the criminal law estops that director from contesting the fact that his breach, or failure to perform, constitutes a violation of the criminal law; but does not estop the director from establishing that he had reasonable cause to believe that his conduct was lawful or had no reasonable cause to believe that his conduct was unlawful;

2. A transaction from which the director derived an improper personal benefit, either directly or indirectly;

3. A circumstance under which the liability provisions of s. 607.0834 are applicable;

4. In a proceeding by or in the right of the corporation to procure a judgment in its favor or by or in the right of a shareholder, conscious disregard for the best interest of the corporation, or willful misconduct; or

5. In a proceeding by or in the right of someone other than the corporation or a shareholder, recklessness or an act or omission which was committed in bad faith or with malicious purpose or in a manner exhibiting wanton and willful disregard of human rights, safety, or property.

(2) For the purposes of this section, the term "recklessness" means the action, or omission to act, in conscious disregard of a risk:

(a) Known, or so obvious that it should have been known, to the director; and

(b) Known to the director, or so obvious that it should have been known, to be so great as to make it highly probable that harm would follow from such action or omission.

(3) A director is deemed not to have derived an improper personal benefit from any transaction if the transaction and the nature of any personal benefit derived by the director are not prohibited by state or federal law or regulation and, without further limitation:

(a) In an action other than a derivative suit regarding a decision by the director to approve, reflect, or otherwise affect the outcome of an offer to purchase the stock of, or to effect a merger of, the corporation, the transaction and the nature of any personal benefits derived by a director are disclosed or known to all directors voting on the matter, and the transaction was authorized, approved, or ratified by at least two directors who comprise a majority of the disinterested directors (whether or not such disinterested directors constitute a quorum);

(b) The transaction and the nature of any personal benefits derived by a director are disclosed or known to the shareholders entitled to vote, and the transaction was authorized, approved, or ratified by the affirmative vote or written consent of such shareholders who hold a majority of the shares, the voting of which is not controlled by directors who derived a personal benefit from or otherwise had a personal interest in the transaction;

(c) The transaction was fair and reasonable to the corporation at the time it was authorized by the board, a committee, or the shareholders, notwithstanding that a director received a personal benefit.

(4) Common or interested directors may be counted in determining the presence of a quorum at a meeting of the board of directors which authorizes, approves, or ratifies such a transaction.

(5) The circumstances set forth in subsection (3) are not exclusive and do not preclude the existence of other circumstances under which a director will be deemed not to have derived an improper benefit.

(6) The provisions of this section shall also apply to officers of non-profit organizations as provided in s.617.0285.

Section 607.07401, transferred from section 607.0740 by section 148, Chapter 90-179 Florida Laws, is entitled "Shareholders' derivative actions," and provides:

(1) A person may not commence a proceeding in the right of a domestic or foreign corporation unless the person was a shareholder of the corporation when the transaction complained of occurred or unless the person became a shareholder through transfer by operation of law from one who was a shareholder at that time.

(2) A complaint in a proceeding brought in the right of a corporation must be verified and allege with particularity the demand made to obtain action by the board of directors and that the demand was refused or ignored. If the corporation commences an investigation of the charges made in the demand or complaint, the court may stay any proceeding until the investigation is completed.

(3) The court may dismiss a derivative proceeding if, on motion by

the corporation, the court finds that one of the groups specified below has made a determination in good faith after conducting a reasonable investigation upon which its conclusions are based that the maintenance of the derivative suit is not in the best interests of the corporation. The corporation shall have the burden of proving the independence and good faith of the group making the determination and the reasonableness of the investigation. The determination shall be made by:

(a) A majority vote of independent directors present at a meeting of the board of directors, if the independent directors constitute a quorum;

(b) A majority vote of a committee consisting of two or more independent directors appointed by a majority vote of independent directors present at a meeting of the board of directors, whether or not such independent directors constitute a quorum; or

(c) A panel of one or more independent persons appointed by the court upon motion by the corporation.

(4) A proceeding commenced under this section may not be discontinued or settled without the court's approval. If the court determines that a proposed discontinuance or settlement will substantially affect the interest of the corporation's shareholders or a class, series, or voting group of shareholders, the court shall direct that notice be given to the shareholders affected. The court may determine which party or parties to the proceeding shall bear the expense of giving the notice.

(5) On termination of the proceeding, the court may require the plaintiff to pay any defendant's reasonable expenses, including reasonable attorney's fees, incurred in defending the proceeding if it finds that the proceeding was commenced without reasonable cause.

(6) The court may award reasonable expenses for maintaining the proceeding, including reasonable attorney's fees, to a successful plaintiff or to the person commencing the proceeding who receives any relief, whether by judgment, compromise, or settlement, and require that the person account for the remainder of any proceeds to the corporation; however, this subsection does not apply to any relief rendered for the benefit of injured shareholders only and limited to a recovery of the loss or damage of the injured shareholders.

(7) For purposes of this section, "shareholder" includes a beneficial owner whose shares are held in a voting trust or held by a nominee on his behalf.